

# INDEX

	Page
Opinions below.....	1
Jurisdiction.....	1
Question presented.....	2
Statutes and regulations involved.....	2
Statement.....	6
Argument.....	8
Conclusion.....	15

## CITATIONS

### Cases:

<i>Biddle v. Commissioner of Internal Revenue</i> , 302 U. S. 573.....	11
<i>Blid v. Wisconsin Foundry and Machine Co.</i> , 243 Wis. 221, 10 N. W. (2d) 142.....	14
<i>Eastern Gas &amp; Fuel A. v. Commissioner</i> , 128 F. 2d 369.....	13
<i>Eliot Nat. Bank v. Gill</i> , 218 Fed. 600.....	13
<i>Ferguson v. Fidelity Union Trust Co.</i> , 24 F. 2d 520.....	13
<i>First Nat. Bank of Jackson, Miss. v. McNeel</i> , 238 Fed. 559.....	13
<i>Keith v. Johnson</i> , 271 U. S. 1.....	10, 11
<i>Magruder v. Supplee</i> , 316 U. S. 394.....	10, 11
<i>Natl. Bank of Commerce v. Allen</i> , 223 Fed. 472.....	13
<i>Northern Trust Co. v. McCoach</i> , 215 Fed. 991.....	13
<i>Porter v. United States</i> , 27 F. 2d 882.....	13
<i>United States v. Guaranty Trust &amp; Savings Bank</i> , 253 Fed. 291.....	13
<i>Wisconsin v. J. C. Penney Co.</i> , 311 U. S. 435.....	8, 9, 10
<i>Wisconsin Gas &amp; Electric Co. v. Wisconsin Department of Taxation</i> , 243 Wis. 216, 10 N. W. (2d) 140.....	10

### Statutes:

Revenue Act of 1921, c. 136, 42 Stat. 227:	
Sec. 214.....	13
Sec. 234.....	13
Revenue Act of 1928, Sec. 131(a)(1).....	11
Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 23....	2, 12, 13, 14
Laws of Wisconsin (1935), c. 505, Sec. 3, as amended by Laws of Wisconsin (1935), c. 552, Sec. 1, and Laws of Wisconsin (1937), c. 233, Sec. 1.....	3-6

### Miscellaneous:

I. T. 3002, XV-2 Cum. Bull. 142 (1936).....	6
S. Rep. No. 275, 67th Cong., 1st Sess., p. 19.....	13
Treasury Regulations 86:	
Art. 23(c)-1.....	3
Art. 23(d)-1.....	3



# In the Supreme Court of the United States

OCTOBER TERM, 1943

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No. 565

WISCONSIN GAS & ELECTRIC COMPANY, PETITIONER

v.

THE UNITED STATES OF AMERICA

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH  
CIRCUIT

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BRIEF FOR THE UNITED STATES IN OPPOSITION

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## OPINIONS BELOW

The opinion of the district court (R. 6-8) is reported in 46 F. Supp. 929. The opinion of the circuit court of appeals (R. 20-23) is reported in 138 F. (2d) 597.

## JURISDICTION

Judgment of the circuit court of appeals was entered on November 8, 1943 (R. 23). The petition for writ of certiorari was filed on December 30, 1943. The jurisdiction of this Court is

invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

#### QUESTION PRESENTED

Whether the Wisconsin Gas and Electric Company, in computing its net income for the year 1935, is entitled under Section 23 (c) or (d) of the Revenue Act of 1934 to a deduction for amounts paid to the State of Wisconsin pursuant to the privilege dividend tax law of that state.

#### STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

##### SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions;

\* \* \* \* \*

(c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, except—[exceptions not material].

\* \* \* \* \*

(d) *Taxes of Shareholder Paid by Corporation.*—The deduction for taxes allowed by subsection (c) shall be allowed to a corporation in the case of taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.

\* \* \* \* \*

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (c)-1. *Taxes*.—Subject to the exceptions stated in this article and articles 23 (c)-2 and 23 (c)-3, \* \* \* [exceptions not material] taxes imposed by \* \* \* any State or Territory \* \* \* are deductible from gross income for the year in which paid or accrued \* \* \*. In general taxes are deductible only by the person upon whom they are imposed. \* \* \*

ART. 23 (d). *Tax on bank or other stock*.—Banks or other corporations paying taxes assessed against their shareholders on account of their ownership of the shares of stock issued by such corporations without reimbursement from such shareholders may deduct the amount of taxes so paid. The Act specifically provides, however, that in such cases the shareholders may not deduct the amount of the taxes. The amount so paid should not be included in the income of the shareholder.

\* \* \* \* \*

Laws of Wisconsin (1935), c. 505, Sec. 3, as amended by Laws of Wisconsin (1935), c. 552, Sec. 1, and Laws of Wisconsin (1937), c. 233, Sec. 1:

#### SECTION 3. PRIVILEGE DIVIDEND TAX. (1)

For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to two and one-half per centum of

the amount of such dividends declared and paid by all corporations (foreign and local), *except those specified in paragraphs (d) and (g) of Section (1) of Section 71.05 of the Statutes,*<sup>1</sup> after the passage and publication of this act and prior to July 1, 1937. Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation.

(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chap-

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<sup>1</sup> The clause in italics was inserted by Laws of Wisconsin (1937), c. 233, Sec. 1. Section 4 of that chapter gives this amendment retroactive and prospective effect. Sections 71.05 (1) (d) and (g), Wisconsin Statutes, contain the exemption provisions of the Wisconsin income-tax law.

ter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state.

(5) Dividends paid by a subsidiary corporation to its parent shall not be subject to the tax herein imposed provided that the subsidiary and its parent report their income for taxation under the provisions of chapter 71 on a consolidated income return basis, or both corporations report separately.

(6) The provisions of this section shall not apply to dividends declared and paid by a Wisconsin corporation out of its income which it has reported for taxation under the provisions of chapter 71, to the extent that the business of such corporation consists in the receipts of dividends from which a privilege dividend tax has been deducted and withheld and the distribution thereof to its stockholders.

(7) For the purposes of this section dividends shall be defined as in section 71.02, except that the tax herein imposed shall



not apply to stock dividend or liquidating dividends.

(8) The tax hereby levied, if not paid within the time herein provided, shall become delinquent and when delinquent shall be subject to a penalty of two per cent on the amount of the tax and interest at the rate of one-half per cent per month until paid.

(9) The tax hereby imposed shall, when collected by the tax commission, be paid by it into the state treasury.

\* \* \* \* \*

#### STATEMENT

The petitioner is a Wisconsin corporation doing business wholly within that State as a utility company (R. 5).

On its final income tax return for the calendar year 1935, petitioner claimed a deduction from gross income of \$3,750 for payment of the Wisconsin privilege dividend tax (R. 5).

Following an audit by a revenue agent, a deficiency assessment of additional tax in the amount of \$11,696 was made with respect to petitioner's income for 1935 (R. 5). This deficiency assessment was predicated in part on the disallowance of the deduction for the dividend tax<sup>2</sup> (R. 6).

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<sup>2</sup> Disallowance of this deduction was pursuant to I. T. 3002, XV-2 Cum. Bull. 142 (1936), which provides:

"Advice is requested whether, for Federal income tax purposes, the corporation paying a dividend or the stockholder



To this deficiency assessment was added interest in the amount of \$847.56,<sup>3</sup> bringing the total to \$12,543.56 (R. 5). Of this amount, \$12,504.30 was paid by petitioner on May 10, 1937, and on October 26, 1937, the remainder of the assessment, namely, \$39.26, was abated (R. 6).

On May 9, 1939, petitioner timely filed with the Collector of Internal Revenue a claim for refund of tax paid with respect to income of 1935, one ground of which was petitioner's claim for deduction of dividend tax ~~paid~~ in that year. This claim for refund to the extent based upon the deduction for dividend tax was denied by the

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receiving it is entitled to deduct the privilege dividend tax of 2½ per cent imposed by the State of Wisconsin under section 3 of chapter 505, Laws of Wisconsin, 1935.

\* \* \* \* \*

"The title of the law and its provisions show that it was the intention of the State legislature to levy an excise tax on the receipt of dividends and to make the corporation declaring and paying the dividend the collector of the tax for and on behalf of the State by requiring the corporation to withhold the tax from the stockholder and to pay the amount withheld to the State tax commission, which in turn pays it into the State treasury.

\* \* \* \* \*

"It is held that the privilege dividend tax is an excise tax imposed upon the stockholder receiving the dividend, who may deduct the amount of the tax in his Federal income tax return. The stockholder, however, should report in his return the full amount of the dividend, including the tax withheld."

<sup>3</sup> In paragraph 5, stipulation for agreed statement of facts (R. 5), the amount of interest was erroneously stated to be \$847.96. The difference is immaterial here.

Commissioner of Internal Revenue on October 31, 1940 (R. 6). The present action for recovery of refund on this ground was commenced on February 19, 1941 (R. 3).

The district court filed its opinion in this case on September 25, 1942 (R. 6-8), to the effect that petitioner was entitled to a deduction for the dividend tax here involved. This conclusion was predicated by the district court entirely upon the decision of this Court in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435. Pursuant to this opinion judgment by the district court was filed on October 6, 1942 (R. 10-11).

On appeal to the United States Circuit Court of Appeals for the Seventh Circuit that court on November 8, 1943, rendered a decision holding that taxpayer was not entitled to the deduction for dividend tax (R. 20-23). The judgment of the district court was reversed (R. 23).

#### ARGUMENT

1. In support of its petition for a writ of certiorari the petitioner asserts that the decision below conflicts with the decision of this Court in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435. We submit that no such conflict exists.

In the *Penney* case this Court had before it the constitutional validity of the Wisconsin dividend tax statute as applied to a Delaware corporation, with its principal offices in New York,

but doing business in the State of Wisconsin and other states, and having stockholders in the State of Wisconsin and other states. The decision upheld the validity of the dividend tax as against claims of violation of the Fourteenth Amendment to the Constitution of the United States. While it is true that, in the course of its analysis of the "practical operation" of the dividend tax, this Court in the *Penney* case likened the tax to "an additional tax on corporate earnings within Wisconsin" (p. 442), the opinion does not appear to contain, either expressly or by necessary implication, any holding that the tax is one imposed on the corporation itself, as distinguished from its stockholders. Rather, the Court appears to have concerned itself primarily with the question "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state," or, as alternatively stated in the opinion, "whether the state has given anything for which it can ask return" (p. 444). This question the Court answered in the affirmative, holding that "the substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax" (pp. 444-445).

The *Penney* case thus established the constitutional validity of the dividend tax as applied to foreign corporations. There being no question here presented as to the constitutionality of the

dividend tax,<sup>4</sup> the only question before the court below was whether this tax, already held in the *Penney* case to be a constitutional exaction, was imposed on the petitioner or on its stockholders. This question, which was not decided or involved in the *Penney* case,<sup>5</sup> depends in turn for its answer upon Wisconsin law (*Keith v. Johnson*, 271 U. S. 1, 8; *Magruder v. Supplee*, 316 U. S. 394, 396), and since the decision of the district court herein it has been unequivocally answered by the Supreme Court of Wisconsin contrary to the contentions of the petitioner. *Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation*, 243 Wis. 216, 10 N. W. (2d) 140 (1943); *Blid v. Wisconsin Foundry & Machine Co.*, 243 Wis. 221, 10 N. W. (2d) 142 (1943). These decisions of the Wisconsin Supreme Court, holding that the tax is imposed on the stockholders rather than the corporation, were concededly followed by the court below, and its action in following them is in accord with applicable decisions of this Court, and presents no question requiring review by this Court.

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<sup>4</sup>The petitioner is a Wisconsin corporation, and is not shown even to have foreign stockholders (R. 23). As the court below said (R. 23): "Power to tax was the only question before the court in the *Penney* case. Who shall be entitled to enjoy some incidence of the tax payment is our question. \* \* \* the factual situation is clearly distinguishable from the *Penney* case."

<sup>5</sup>There was no suggestion in the *Penney* case that the benefits flowing from "the substantial privilege of doing business in Wisconsin" must be entirely absorbed by the cor-

2. Nor does the decision below present any conflict with the decision of this Court in *Biddle v. Commissioner of Internal Revenue*, 302 U. S. 573. There this Court, in the apparent absence of controlling English decisions, considered and construed the British tax law, and held that American taxpayers who had received dividends on their stock in British corporations were not entitled under Section 131 (a) (1) of the Revenue Act of 1928 to a credit for "income \* \* \* taxes paid or accrued during the taxable year to [a] foreign country," measured by their respective proportions of the tax paid by the British corporations to the British Government on the profits out of which the dividends were declared. Passing differences between the British income tax law and the Wisconsin dividend tax law, it is apparent that here the Wisconsin Supreme Court has explicitly construed the dividend tax law on the precise point at issue. Under the settled doctrine of this Court, that construction should under the circumstances presented here be accepted by the federal courts. *Keith v. Johnson*, 271 U. S. 1, 8; *Magruder v. Supplee*, 316 U. S. 394, 396.

In the *Biddle* case this Court held that the application of the term "income taxes paid" as used in the Revenue Act of 1928 was not to be de-

poration in order to sustain the constitutionality of the tax. A postulate of the case was that the benefits, at least to a degree, flowed on to the stockholders and were enjoyed by them in the form of dividends out of corporate earnings.

terminated by any "shifting standard . . . adopted by reference to foreign characterizations and classifications of tax legislation," but rather by "an examination of the statutes which provide for the laying and collection of income taxes" in order to determine "what the stockholder has done . . . and whether it is the substantial equivalent of payment of the tax as those terms are used in our own statute" (p. 579). We take this to mean no more than that in the absence of clear determination by the local courts as to the actual incidence of a state or foreign tax, the federal courts are to examine the question for themselves, accepting available "foreign characterizations and classifications" not as controlling authority, but as "a factor to be considered in deciding whether the stockholder pays the tax." Here, the Wisconsin Supreme Court has determined that the actual incidence of the dividend tax is on the stockholder, and not on the corporation—that is, that the stockholder pays the tax. Under the rule of the cases cited the determination of that court should under the circumstances here presented be regarded as conclusive of the issue.

3. The petitioner contends, as an alternative ground for recovery, that it is in any event entitled to the deduction permitted by Section 23 (d) of the Revenue Act of 1934 for "taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid



by the corporation without reimbursement from the shareholder.”\*

This contention rests on an assumption that the tax, if regarded as imposed on the stockholder rather than the corporation, is imposed “upon his interest as shareholder.” This assumption is refuted by the legislative history of Section 23 (d) and has no support in judicial decisions. In *Eastern Gas and Fuel A. v. Commissioner*, 128 F. (2d) 369 (C. C. A. 1, 1942), it was held that “the use of the term ‘interest’ relates to a tax upon the ownership of stock and not to the income derived therefrom,” and that therefore

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\* This contention was likewise pressed before the court below, although not considered by that court in its opinion.

Section 23 (d) was derived from Sections 214 (a) (3) (d) and 234 (a) (3) of the Revenue Act of 1921. These provisions in turn had been adopted to resolve a controversy which had given rise to considerable litigation, under earlier revenue acts, as to the proper person entitled to deduction for state intangible personal property taxes, imposed largely upon bank stock. Cf. *Porter v. United States*, 27 F. (2d) 882 (C. C. A. 9, 1923); *First Nat. Bank of Jackson, Miss. v. McNeel*, 238 Fed. 559 (C. C. A. 5, 1917); *Natl. Bank of Commerce v. Allen*, 223 Fed. 472 (C. C. A. 8, 1915); *Eliot Nat. Bank v. Gill*, 218 Fed. 600 (C. C. A. 1, 1914), and *Northern Trust Co. v. McCoach*, 215 Fed. 991 (E. D. Pa., 1914), in all of which it had been held that the state intangible personal property tax was imposed upon the stockholder and deductible only by him; contra, *Ferguson v. Fidelity Union Trust Co.*, 24 F. (2d) 520 (C. C. A. 3, 1928); *United States v. Guaranty Trust & Savings Bank*, 253 Fed. 291 (S. D. Fla., 1918). The limited purpose of the provision in the Revenue Act of 1921 is shown by the report on the bill by the Senate Committee on Finance (S. Rep. No. 275, 67th Cong., 1st sess., p. 19).



Section 23 (d) did not permit a deduction to a Massachusetts trust for state income taxes paid by it with respect to dividends paid to its preferred stockholders. We are aware of no conflicting cases, and the petitioner cites none. At no point in the extensive litigation relating to the Wisconsin dividend tax law has there been any suggestion that the tax in any way resembles an *ad valorem* tax imposed upon a property interest.

Furthermore, as shown above, the Wisconsin Supreme Court has held that, although as a convenient mechanical device the tax is collected from the corporation, the incidence of the tax is not upon the corporation but upon the stockholder. The holding of that court in *Blid v. Wisconsin Foundry & Machine Co.*, 243 Wis. 221, 10 N. W. (2d) 142 (1943), was that the stockholder cannot recover from the corporation his proportion of the dividend tax paid because the tax is imposed upon him and not upon the corporation. This holding carries with it the corollary that even if the corporation is regarded as paying the tax in the first instance it is entitled to reimbursement out of funds belonging to the stockholder. A corporation so entitled to reimbursement does not fall within the class of taxpayers entitled to deduction under Section 23 (d).

We submit, therefore, that this argument is without merit, and that in any event it presents

no conflict of decisions nor any other ground for review by this Court.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1944.